Prepared Statement of the Rural Cellular Association

Before the
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En Banc Hearing

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The Rural Cellular Association ("RCA") is an association of small wireless service providers operating in over 135 rural and small metropolitan areas throughout the country. On behalf of the RCA, I appreciate this opportunity to provide information to the Joint Board regarding issues that are vitally important to the people who live and work in rural America.

The implementation of the Telecommunications Act of 1996 ("Act"), and the realization of its stated goal of opening all telecommunications markets to competition, has been a struggle. Success has not always been easy, and it has not always happened as quickly as many people would have liked. And not surprisingly, the realization of the Act's goals occurred first in areas of high population density.

Now, some seven years into the process of introducing competitive market forces into areas previously characterized by monopoly supply, serious efforts to expand this success to rural areas have begun. In many cases, the larger carriers – both wireline and wireless – have focused their efforts on competing primarily in urban areas. Smaller carriers, including RCA members, are the carriers dedicated to providing competitive alternatives in rural America.

As the introduction of competition has begun to expand into areas of lower population density, the response from the former monopoly suppliers has by and large been a predictable one: the rural ILECs have sought to erect barriers to this competition wherever possible. The call for fundamental changes in the existing mechanism for providing high cost support – a mechanism that was adopted after years of extensive study and careful consideration – represents one such effort.

Before accepting the ILEC's invitation to tear down and rebuild the existing universal service mechanism, I respectfully urge you to take a step back from the problem and carefully consider exactly what it is that is allegedly "broken." When doing so, it is critical that the issues to be addressed are not defined based on artificial constraints or previous technological limitations. If the questions are posed too narrowly, the list of possible answers will likewise be artificially limited.

It is useful to take a minute and take stock of where we are as the existing high cost mechanism continues to operate.

- Investment is being made in rural areas that would not otherwise have been made. The amount of this investment is *not* limited to the amount of universal service support received, but instead represents significant investment of private capital made feasible because of the portability of support.

- People who live or work in rural areas are beginning to have access to competitive alternatives for telecommunications services. These alternatives include pricing plans tailored to the needs of the customer and the opportunity to choose a technology that is advantageous to the customer.

- The existence of these competitive alternatives, particularly wireless alternatives, enables rural areas to compete successfully with urban areas in their attempts to attract capital investment and jobs.

- People living in rural areas have begun to be able to take advantage of the health and safety benefits of wireless services. The importance of these benefits are often under-appreciated by people living in urban areas.

Where, then, is the problem that justifies the dismantling of the existing high cost mechanism? The collective outcry from the ILECs has increased in volume as more designations of Competitive Eligible Telecommunications Carriers ("CETCs", in contrast to qualifying incumbent, or "IETCs") have been made, and a rallying cry of "we must stop this before its too late" has been taken up. But what exactly is the "this" that must be stopped? The flow of private capital into rural areas that would not have been possible with portable support? Competitive alternatives for customers who have never had one? Pricing plans with expanded local calling and reduced rate or flat-rated long distance calling? Wireless coverage that makes a rural area an attractive location for corporate or industrial relocation? A mobile communications service that addresses significant health and safety concerns left unaddressed by the incumbents?

The only real "this" offered up by the incumbents to date has been "the fund will get too big." Clearly, stewardship of the fund, including careful consideration of its size and the available funding sources, is important. But responsible stewardship also means considering all of the various sources (and their relative contribution) to fund size, whether such growth was anticipated, and – most importantly – the size of the fund over the long term.

While oft-repeated, the assertion that CETCs, and particularly wireless CETCs, are responsible for any significant portion of the growth in the fund to date is purely a myth. Contribution to CETCs continues to represent a very small part of the total high cost support distributed, and high growth rates are the function of a very small base. To keep things in proper perspective, it is important to remember that wireless providers are on pace to *contribute* about $1.75 billion to the fund in 2003, and on pace to *receive* less than 1% of that amount.

Even if support to CETCs did constitute a significant portion of the total high cost fund, a strategy of limiting or eliminating support to CETCs is not the best or only response. Early experience indicates that $1 of support to a CETC may mean $2, or $4, or $10 of new investment in a rural area, and the service offered by the CETC may have significant advantages over the service offered by the ILEC. A strategy of protecting an ILEC simply because it was "first in" the market is not a sound public policy and is directly at odds with the goals of the Act.

It is critical that the fund be managed on a long run basis. Attempts to minimize the size of the fund over the short run, especially of such attempts have the effect of limiting competitive entry, are likely to result in a larger than necessary fund over the long run. The Act does not state that the transition from monopoly to competitive markets should take place only if it can be undertaken at no cost. The long term benefits of competition will outweigh the short term cost of continuing to apply the existing high cost funding mechanism.

Should competitive ETCs continue to receive the same per-line support as incumbent LECs? Should their support be determined on some other basis, such as their own costs?

The answers to these questions are extremely important and have critical time dimensions. During the period of time that it takes a CETC make the network investments necessary to provide comprehensive service throughout an area and to provide a service that consumers can purchase as a substitute for the ILEC's service, the answer to the first question must be yes. After the CETC's network buildout has been completed, it will be appropriate to go to a mechanism in which support is based on the costs of the most efficient provider.

CETCs, and particularly wireless CETCs, are making these network investments today. While the availability of high cost support makes this investment feasible, the investment is not limited to high cost funds. To the contrary, the wireless CETC's construction plans, commitments to state regulators, and long term contracts for equipment purchases make it very clear that private capital will be invested. In short, while the rural ILECs may not welcome the competition, the existing high cost mechanism is working, and the objectives of the Act are beginning to be met in rural areas.

The current mechanism is working, and should not be abandoned, for several reasons:

The current high cost mechanism is economically rational and should yield the desired results. The current mechanism, though imperfect because of its reliance on the ILEC's embedded rather than economic costs, does a good job of sending the correct signals to the marketplace. Entry is encouraged where it is efficient, and the mechanism discourages market entry by a potential CETC where it is not efficient.

In terms of both operating efficiency and the technology underlying its network, a CETC's costs are either (1) higher than those of the IETC, (2) equal to those of the IETC, or (3) lower than those of the IETC.

If the CETC's costs are higher, because it operates inefficiently, relies on a technology that is a less efficient solution for serving the area in question, or both, a CETC that receives support based on the IETC's costs will not find it financially viable to enter the geographic market and invest in facilities. This is the desired result: a less efficient provider should not be encouraged to enter, nor should its entry be supported.

If the CETC incurs costs equal to those of the incumbent, it will find itself on identical financial footing if it receives support based on the incumbent's costs. If the CETC believes that it has a superior basic service or superior complementary services that will make its basic service more desirable, it could rationally enter the market and make the required investments (knowing that it will be on a roughly equal cost footing with its competitor).

If the CETC has a lower cost than the IETC, its entry should be encouraged. If this CETC receives support based on the incumbent's cost, its entry and investment schedule will be accelerated. This scenario is roughly the same as the equal cost scenario, with the exception being that some additional funds may be available to accelerate buildout or other investment. The use of the support funds is the same; their use is restricted to investment, maintenance, and operation. Only the timing changes. The level of the support funds do not confer an advantage – either fair or unfair – upon the CETC: it arrived with an advantage by virtue of its lower cost. That lower cost can result in lower prices to consumers and a smaller fund over the long run.

The existing high cost mechanism does not create a "windfall" for CETCs. The only "windfall" in the current mechanism is created by the use of embedded rather than economic costs, and accrues equally to both IETCs and CETCs. Moving to a per-line support amount based on economic costs will result in more accurate signals sent to the marketplace and a significantly smaller fund.

Any cost advantage between carriers exists independently of the level of support and should not be arbitrarily eliminated. It is perhaps instructive to turn the question around. If support for the CETC is based on a calculation of its lower costs, would support to IETCs based on their higher costs create an unfair advantage for IETCs? The answer is clearly yes – a carrier that should have been at a cost disadvantage in the marketplace (in this case the IETC) will have had that disadvantage artificially eliminated. More importantly, the outcome would be highly undesirable for consumers in the area and society at large: the ILEC would have no incentive to improve efficiency (if this is the source of its higher cost), a high cost technology may be perpetuated (if this is the cause of the higher cost), or both. For the same reasons, a CETC with higher costs than the incumbent should not receive a higher level of support based on this differential.

At the end of the day, support should make competitive entry into a high-cost area feasible where it otherwise would not be, if but only if the potential new entrant has economic costs that are equivalent to, or lower than, the IETC. The level of support to different ETCs should not be used as a tool to equalize cost differences among carriers. Doing so converts a means of ensuring service availability into a means of ensuring the operation of a given carrier.

The consequences of different scenarios using the "equivalent support" and "differentiated support" methods are summarized in Table 1 on the following page:

Table 1: Implications of Equivalent Support versus Differentiated Support

CETC to IETC Cost Relationship (Cost = TSLRIC)	**Equivalent Support** (current mechanism)	*Differentiated Support* (support based on each carrier's cost)
CETC Cost < IETC Cost	IETC cost benchmark sends correct signal to marketplace, CETC has incentive to invest, CETC investment accelerated by amount of cost differential, IETC has incentive to become more efficient, One cost study (IETC) needed, End user benefits from competitive entry and incentives for IETC to become more efficient, Fund size minimized over long run.	IETC cost benchmark sends no signal to marketplace, CETC has incentive to invest but on extended timeframe, IETC inefficiencies protected; no incentive to before more efficient, Two cost studies (IETC and CETC), must have consistent methodologies but may need to reflect different technologies, End user benefits from competitive alternative but not from lower prices, Fund size higher than necessary long run because of institutionalized IETC inefficiency.
CETC Cost = IETC Cost	IETC cost benchmark sends correct signal to marketplace, CETC has incentive to invest, IETC has incentive to become more efficient, One cost study (IETC) needed, End user benefits from competitive entry and incentives for IETC to become more efficient, Fund size minimized over long run.	IETC cost benchmark sends correct signal to marketplace, CETC has incentive to invest, CETC investment accelerated by amount of cost differential, IETC has incentive to become more efficient, Two cost studies (IETC and CETC), must have consistent methodologies but may need to reflect different technologies, End user benefits from competitive entry and incentives for IETC to become more efficient, Fund size minimized over long run.
CETC Cost > IETC Cost	IETC cost benchmark sends correct signal to marketplace, CETC has no incentive to invest, IETC has no incentive to become more efficient, One cost study (IETC) needed, No end user benefits, Fund size may be minimized over long run.	IETC cost benchmark sends no signal to marketplace, CETC has artificial incentive to invest, IETC has no incentive to become more efficient, Two cost studies (IETC and CETC), must have consistent methodologies but may need to reflect different technologies, End user benefits from competitive alternative but not from lower prices, Fund size higher than necessary long run because of potential for inefficient entry.

As Table 1 makes clear, for each scenario (CETC costs less than IETC costs, CETC costs equal to IETC costs, CETC costs greater than IETC costs) the option with the most favorable set of outcomes is the use of an equivalent support mechanism based on ILEC costs. Of course, the benefits to rural consumers are much greater if CETCs exist that have lower costs than the IETC. Whether this is true is independent of how the mechanism operates, and is not within the control of regulators. How consumers in rural areas will fare if a lower cost provider exists is within the Joint Board's and FCC's control, however. Maintaining an equivalent support mechanism based on the IETC's costs assures the best outcome.

Different ways of asking the same fundamental question are as follows: ***Under what circumstances would it be beneficial to discourage market entry and investment by a low cost provider? Under what circumstances would it be beneficial to protect a high cost provider from the effects of competitive market forces?*** Absent a compelling description of such circumstances, there is no benefit to an attempt to differentiate support. On the cost side, the development of support based on a CETC's costs will require the development and application of a set of new cost models similar to the SCM that can accommodate a variety of carrier types, operations, and network technologies. Before the time and necessary expense are incurred, it is reasonable to first determine if the marketplace will provide the necessary information.

Under the existing high cost mechanism, the market will provide information about CETC costs. The only required assumptions are the following: (1) CETCs will not misappropriate support funds, and (2) CETCs are reasonably well managed by people with some insight into their cost structure. A CETC considering entry into a high-cost area will evaluate that entry based on the following consideration: given the level of per-line support available and the number of potential customers that can be reached, should investments rationally be made in this area? A CETC with higher costs than the IETC will not invest (as it should not). A CETC with costs equal to the IETC will have an incentive to invest equal to that of the IETC. A CETC with lower costs than the IETC will invest, with any incremental support funds that result from the cost differential being used to accelerate that investment. In order to determine if the high cost mechanism is operating in a manner that is in the long run interests of both consumers in high cost areas and society at large, the information needed about CETC costs is simply the following: are its costs higher or lower than those of the IETC? This is information that the market can provide without the time and expense of a CETC cost study.

Put another way, a cost study of the IETC's operations is necessary to set a benchmark level of operating/network cost. Support set equal to this benchmark will create the correct set of incentives and signals to the marketplace: If you can beat this cost level, enter with our blessing and receive support funds that must be used for this purpose. If you can't beat this cost level, we already have a lower cost provider so thanks, but no thanks.

Summary

The existing high cost mechanism was adopted after years of hard work and extensive analysis. It should not be abandoned without careful consideration.

Rural ILECs that would point to CETCs, and particularly wireless CETCs, as the underlying cause of growth in the fund need to take a long look in the mirror. The support provided to wireless CETCs has not yet begun to approach the impact on the size of the high cost fund created by the move from "embedded cost recovery" to "modified embedded cost recovery" for the rural ILECs.

The existing mechanism sends the right signals to the marketplace. Potential entrants into a rural market have a cost benchmark with which to compare themselves. Carriers with lower cost (or a potentially more desirable service) have an incentive to enter, and carriers with higher cost have no such incentive. The mechanism has an important self-enforcement element that limits the number of CETCs in a given area. A rational carrier that is considering entry into the area will consider the ILEC cost benchmark, the size of the total market, and the share of that market that it is likely to capture. As additional carriers enter the market, the desirability of the market to a potential future entrant diminishes.

Growth in the size of the fund is a relevant consideration, but the various knee-jerk reactions currently being sponsored by incumbent providers (or others seeking to limit competitive entry) must be avoided. The people who live and work in rural areas deserve better than that. It is inevitable that as implicit subsidies become explicit, the size of the explicit funding requirements will grow. It is inevitable that when rural ILECs are provided with support based on embedded costs, particularly measures of embedded cost that permit more costs to be included, the size of the funding requirements will grow. It is also likely that – over the short term – making high support available to carriers seeking to compete in rural areas will increase the funding requirements. But when deciding on a course of action at this point in time, two important considerations need to be made: not all of the above sources of funding increases are equal in magnitude, and the long term impact on the size of the fund is important.

Current proposals to "solve" the "problem" by limiting the support available to CETCs is off target in both of these areas. Support to CETCs represents a very small portion of the fund; if fund size is to be the only consideration then there are clearly bigger fish to fry. Equally importantly, limiting competitive entry in order to decrease the size of the fund in the short run is almost certain to result in a much larger fund over the long run.